OCT 14 1942
CHARLES ELMORE CROPLEY
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Supreme Court of the United States

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT OF PETITION

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Supreme Court of the United States

OCTOBER TERM, 1942

No.

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

For Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Petitioner, Air Reduction Company, Incorporated, a New York corporation, prays that a writ of certiorari issue to review a decision of the United States Circuit Court of Appeals for the Second Circuit in the above cause, handed down on July 16, 1942, and the decree entered therein on August 1, 1942, ordering and decreeing that the decision of the United States Board of Tax Appeals herein in favor of the petitioner be reversed and the cause remanded.

Statement.

The matter here involved is the liability of the petitioner to Federal income tax under the Revenue Act of 1934, the relevant provisions of which are set forth in Appendix A (*infra*, pp. 14-15). Two questions are presented, arising from the transactions involving petitioner's

capital stock summarized in the following paragraphs numbered I and II.

I. Prior to the close of the year 1935, the petitioner owned 109,952 of the 132,299 shares of stock of Pure Carbonic Company, a corporation engaged in an allied activity and operated as a subsidiary of the petitioner (R. 17). The remaining 22,347 shares were owned by U. S. Industrial Alcohol Company (R. 17); and prior to the close of the year 1935 the petitioner acquired those shares, in exchange for 5,258 shares of the petitioner's own stock, thus giving petitioner 100% ownership (R. 16-17). Of the shares previously owned by petitioner, 87,275 shares had previously been acquired in exchange for petitioner's stock (R. 17), so that a total of 109,622 shares, or over 82% of the stock of the subsidiary, was acquired solely in exchange for petitioner's own stock, the remaining shares having been purchased from time to time for cash (R. 17). The value of the 22,347 shares acquired from U. S. Industrial Alcohol Company was $888,602 (R. 16); and the cost to petitioner of the 5,258 shares of its own treasury stock issued in exchange therefor, computed under the "first-in, first-out" method, was $182,536.73 (R. 16). Respondent claimed that the difference between those two amounts, $706,065.27, constituted taxable income to the petitioner (R. 16-17).

II. In 1933, the petitioner had given various of its officers options to purchase shares of its stock, for the purpose of giving them an incentive stock interest, at $57.65 a share, which was the average cost of the treasury stock which the petitioner then held (R. 17). During the year 1935, the petitioner sold 3,200 shares of its treasury stock to such officers, pursuant to such options, for a total of $184,480 (R. 17). Computed under the "first-in, first-out" method, the cost to petitioner of the shares so sold was

$120,973.81 (R. 17); and the respondent claimed that the difference between those amounts, $63,506.19, was taxable income to the petitioner.

Prior to May 2, 1934, the Treasury regulations, commencing with those issued under the Revenue Act of 1918, had uniformly provided that a corporation realized no gain or loss from the purchase or sale of its own stock. By T. D. 4430, approved May 2, 1934, the existing provision to that effect contained in Article 66 of Regulations 77 was amended; and the amendment was continued in Article 22(a)-16 of Regulations 86, issued under the Revenue Act of 1934. Copies of the original and the amended regulation are hereto appended, marked "Appendix B" and "Appendix C," respectively (*infra*, pp. 17 and 18).

The retroactive effect of the amendment was considered by this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, in which it was held that the amendment could not be applied retroactively to transactions occurring during the year 1929. Following a dictum in the Court's opinion in that case, the United States Board of Tax Appeals held in the present case that the amended regulation was not effective during the year 1935 (R. 18-19). The Board further held that in any event neither of the transactions in question came within the scope of the amended regulation and that the petitioner had not realized any taxable income from either of them (R. 19-20).

The order of the Board of Tax Appeals was reversed and the cause remanded by the Circuit Court of Appeals for the Second Circuit, Judge Learned Hand dissenting (Decree, R. 44; Opinions, R. 35-43). It is submitted that the Court erred in reversing the order and in holding that any taxable income had been realized by the petitioner from either of the transactions in question, and that the order and decision of the Board should have been affirmed.

Jurisdiction.

Under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, and under Section 8(a) of the said Act, it is competent for this Court to grant the petition herein and to review the said decision and decree of the Circuit Court of Appeals, which decree was entered on August 1, 1942, as above stated. This petition is presented on October 14, 1942.

Questions Presented.

The questions presented are:

1. Did the petitioner realize taxable income in thus acquiring, in exchange for shares of its treasury stock, the last outstanding minority shares of stock of a subsidiary corporation, the total shares of its subsidiary's stock acquired solely in exchange for petitioner's voting stock being over 80%?

2. Did the petitioner realize taxable income in thus selling to certain of its officers under options previously given to them, pursuant to an incentive stock interest plan, shares of its treasury stock at the average cost to petitioner of the treasury stock held at the time the options were given?

Reasons for Allowance of Writ.

Both questions present important questions of federal law which have not been, but should be, settled by this Court. Moreover, the decision of the Circuit Court of Appeals upon the first question is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Dana*, 103 F. (2d) 359, and misapplies

the decision of this Court in *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194.

WHEREFORE, it is respectfully submitted that the petition should be granted.

Washington, D. C.

October 14, 1942.

HARRY W. FORBES,
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SHEARMAN & STERLING,
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Supreme Court of the United States

OCTOBER TERM, 1942.

No.

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION

Opinions Below.

The opinion of the Board of Tax Appeals was a Memorandum Opinion, noted at 44 B. T. A. 1348 but not otherwise reported. The opinion of the Circuit Court of Appeals has not yet been reported.

Jurisdiction.

The decree of the Circuit Court of Appeals herein was entered on August 1, 1942 (R. 43). The accompanying petition for a writ of certiorari will be filed on or before October 14, 1942. Jurisdiction to issue the writ is conferred by Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, and by Section 8(a) of the said Act. The questions involved are important questions of federal law arising under the Revenue Act of 1934.

Statement and Specification of Error.

The questions presented, and the facts upon which they arise, together with the errors alleged, have been set forth in the petition (*supra*, pp. 1-5).

Argument.

I. The question whether a corporation realizes profit or loss, for income tax purposes, on the purchase and sale of its own capital stock is one of wide import and general importance.

In the present case, the petitioner has been held to have realized a taxable profit of over $700,000 because, in issuing 5,258 shares of its own stock in exchange for the last outstanding minority shares of a subsidiary Company, it issued shares which it had previously purchased and was holding as treasury stock. If the petitioner had increased its authorized capital stock by 5,258 shares and had issued the new shares in exchange for the subsidiary company stock, concededly no profit or loss would have been realized. In the case of any large corporation, however, such increases of stock under present statutes relating to notice, proxies, registration, etc., involve considerable delay and substantial expense, all of which was avoided in the present case by the use of shares previously purchased and held as treasury stock. The question whether such use of treasury stock, instead of new stock, affects the corporation's income tax liability is one of general importance and should be passed upon by this court.

Obviously, it made no actual difference to the petitioner (aside from the delay and expense already mentioned) whether it issued new shares or treasury stock. In either case, the assets of the corporation were increased by the remaining shares of the subsidiary company, against which the corporation had 5,258 more of its own shares outstanding in the hands of the public. To hold that the corporation realized profit or loss in the one case but not in the other is to disregard the actual facts and all sound principles of accounting previously recognized by the Treasury Department. Suppose that the situation were reversed

and that the original cost to the corporation of the treasury stock had been $700,000 *more* than the stock (and the subsidiary company's shares) was worth, at the time the stock was re-issued. Would the Treasury Department, or this Court, be prepared to hold that the corporation had sustained a *loss* of $700,000 in thus reissuing the treasury stock, instead of new stock, for the subsidiary company's remaining shares? Yet if there was a $700,000 profit in the one case, it would necessarily follow that there would be a $700,000 loss in the other.

II. As pointed out at length in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, until the May 2, 1934 amendment the Treasury regulations, commencing with those issued under the 1918 Act, had uniformly provided, in accordance with the great weight of accounting authority, that a corporation realized no profit or loss on the purchase or sale of its own capital stock. Following the 1918 Act, the Revenue Acts of 1921, 1924, 1926, 1928 and 1932 were enacted, without any material change in the statute or the regulations; and as the bill which became the Revenue Act of 1934 had been introduced in Congress and passed by both Houses[1] several months before the amendment of May 2, 1934, there is no ground for claiming that the 1934 Act authorized or approved any change in the established rule that no taxable income was realized from such transactions, under the general definition of gross income contained in that Act and prior Acts.

The statement in the majority opinion below (R. 37-8) that the original regulation had not been followed in all cases by the courts and that the amendment was promulgated for that reason is without any foundation. Some

[1] By House of Representatives, February 21, 1934; by Senate, March 28 1934.

decisions of the Board of Tax Appeals had misapplied the regulation, in cases where a corporation had *received* its own stock in payment for property sold, by holding that the provision that a corporation realized no profit or loss from the *purchase of its own stock* prevented a corporation from being taxed on the profit it received *from the sale of its property,* if it received its own stock as part of the purchase price[1]. The courts, however, had uniformly held in all such cases that, in computing the profit or loss from the sale of the property, the stock so received must be treated as the equivalent of cash, at its fair market value.

Walville Lumber Co. v. *Commissioner,* 35 F. (2d) 445;

Spear & Co. v. *Heiner,* 54 F. (2d) 134, affd. 61 F. (2) 1030;

Commissioner v. *S. A. Woods Mach. Co.,* 57 F. (2d) 635, rev'g 21 B. T. A. 818, cert. den. 287 U. S. 613;

Commissioner v. *Boca Ceiga Development Co.,* 66 F. (2d) 1004.

To the same effect, decided after the amendment:

Dorsey Co. v. *Commissioner,* 76 F. (2d) 339, cert. den. 296 U. S. 589;

Allyne-Zerk Co. v. *Commissioner,* 83 F. (2d) 525;

Hammond Iron Co. v. *Commissioner,* 122 F. (2d) 4.

What was held in those decisions was specifically covered in the next to the last sentence of the amended regula-

[1] e. g., *Houston Brothers Co.,* 21 B. T. A. 804, immediately followed by *S. A. Woods Machine Co., id.* 818, which went so far as to hold that a corporation which received its own stock in payment of damages in an infringement suit received no taxable income.

tion (Appendix C, p. 18, *infra*), providing that gain or loss in such cases was to be computed in the same manner as though the payment had been made in any other property; and that sentence could equally as well have been added to the original regulation, without any change in the provision that a corporation realized no profit or loss from the sale or purchase of its stock.

The change made in the body of the regulation was a paraphrase of certain dicta in *Commissioner* v. *S. A. Woods Mach. Co.* (*supra*). The amendment did not mention treasury stock and, when first promulgated, was apparently intended to cover only cases where a corporation was "dealing in" its own stock as it might in shares of another corporation (i. e., regularly buying and selling its own stock for the purpose of making a profit). It was so construed in the first published ruling involving the amendment (G. C. M. 12955, XIII-1 C. B. 107); and such limited application is apparently the only one for which there is any accounting authority whatever.[1]

It is submitted that there is no sound ground for construing the amendment as applicable to other cases,[2] and that, if it could be construed as applying to the present case, the amendment was arbitrary and unreasonable and not warranted by law.

III. The sale of treasury stock to petitioner's officers bore no resemblance to dealing in the shares of another

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[1] The only authority to that effect cited in the Government's brief below was Montgomery (also cited in G. C. M. 12955, *supra*), in 66 Journal of Accountancy, page 112, replying to May, *id.*, page 17. *Contra*, see authorities cited in *Helvering* v. *R. J. Reynolds Tobacco Co.* (*supra*) and compilation of authorities, including S. E. C. Accounting Series, Release No. 6, in "Income Tax Aspects of a Corporation's Dealings in Its Own Shares," Univ. of Pennsylvania Law Review, May, 1941, pages 934, 953-9.

[2] In the *Reynolds Tobacco Co.* case (*supra*), the corporation was apparently dealing in its own stock, within the meaning of the amendment; and in *Allen* v. *National Manufacture & Stores Corp.*, 125 F. (2d) 239, *cert. den.* May 4, 1942, the corporation had bought its own stock on margin and later sold it at a profit, although the original intention had been to retire the stock eventually.

corporation, as pointed out in the dissenting opinion below (R. 42). Moreover, no actual profit was made on those sales, since the option price was the actual average cost to the petitioner of the treasury stock which it then held (R. 17). The alleged profit resulted solely from the application of the arbitrary and artificial "first-in, first-out" rule.

IV. It is further submitted that the issuance of the treasury stock for the remaining outstanding minority shares of a subsidiary company was expressly exempt from tax, under the relevant reorganization provisions of the Revenue Act of 1934 (Appendix A, pp. 14-15, *infra*) and that the decision of the court below conflicts upon that point with the decision of the Third Circuit in

Commissioner v. *Dana,* 103 F. (2d) 359.

In the case cited, the Spicer Manufacturing Company owned approximately two-thirds of the stock of the Salisbury Axle Company, the remaining one-third being owned by Dana. In 1929, Dana exchanged his Salisbury stock for Spicer stock, reporting no profit on the ground that the transaction was an exempt exchange under the reorganization provisions of the Revenue Act of 1928. The 1928 Act [Sec. 112(i) Appendix A, pp. 15-16, *infra*] defined a reorganization as including the acquisition of a majority of the stock of another corporation, instead of 80% of the stock as required in the 1934 Act; and the Commissioner claimed that since the Spicer Company already owned a majority of the stock of the Salisbury Company, the acquisition of the remaining stock from the sole minority stockholder was not a reorganization within the terms of the statute. The Board of Tax Appeals unanimously held the transaction within the statutory exemption (36 B. T. A. 97); and their decision was unanimously affirmed by the Circuit Court of Appeals (*supra*).

In the present case, the petitioner had previously acquired 87,275 shares of the subsidiary's stock in exchange for its own stock, so that the acquisition of the last 22,347 shares by the transaction in question brought the total number of shares acquired solely in exchange for petitioner's own stock to 109,622 shares, or over 82% of the stock of the subsidiary company. Neither in the present case nor in the *Dana* case was there any written plan of reorganization.

The Court below held that the transaction did not come within the reorganization sections because the petitioner had also acquired the remaining 18% of the subsidiary's stock by cash purchases (R. 41), citing "Cf. *Helvering* v. *Southwest Consolidated Corp.*, 315 U. S. 194." The latter case did not deal with the acquisition of stock. It dealt with the acquisition of the *properties* of another corporation in exchange, not only for stock, but for cash and warrants as well. Hence, as this Court pointed out, the transaction did not come within the terms of the 1934 Act, since the exchange was not solely for voting stock.

Where, however, as in the present case, over 80% of the *stock* of another corporation is acquired solely in exchange for voting stock, that is all that the statute requires. If the petitioner had never acquired any of the remaining 18% of the stock, there could be no question but that the acquisition of 82% of the stock brought the case squarely within the terms of the statute. Obviously, it was not taken out of the terms of the statute by the fact that the petitioner had at various times acquired the remaining 18% of the stock by cash purchases. Such incidental cash purchases of stock which cannot be acquired by exchange are a common feature of almost all reorganizations; and if, as the Court below has held, such incidental cash purchases take the case out of the statute even where the required amount of stock has been acquired solely in

exchange for voting stock, the question is one of great general importance which should be passed upon by this Court.

V. It is submitted that, for the reasons just pointed out, the decision of the Court below on the first issue is in conflict with the decision of the Circuit Court of Appeals for the Third Circuit on the same matter and is based upon a misapplication of the decision of this Court in the *Southwest Consolidated* case (*supra*), and that both issues herein present federal questions of general importance which have not been, but which should be, decided by this Court.

VI. The petition for a writ of certiorari herein should be granted.

Washington, D. C.,
October 14, 1942.

Respectfully submitted,

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APPENDIX A.

Relevant Statutory Provisions.

Revenue Act of 1934:

Section 22(a):

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Section 112:

"(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

* * * * *

"(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

* * * * *

"(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term 'reorganization' means (A) a statutory merger or consolidation, or (B) the

acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

In the Revenue Act of 1928, the corresponding provisions of Section 112 were identical with those above quoted, except that subdivision (g), containing the definition of reorganization, appeared as subdivision (i) and read as follows:

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or

both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."

APPENDIX B.

Article 66 of Regulations 77.

"*Sale by corporation of its capital stock.*—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176)."

APPENDIX C.

T. D. 4430, approved May 2, 1934, XIII-I C. B. 36, purported to amend Article 66 of Regulations 77 (and corresponding Articles of prior Regulations for the preceding ten years) to read as follows:

> "*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.
>
> But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

Article 22(a)-16 of Regulations 86, issued under the Revenue Act of 1934, was identical with the above, except that the last two words were "the Act," instead of "applicable statutes."

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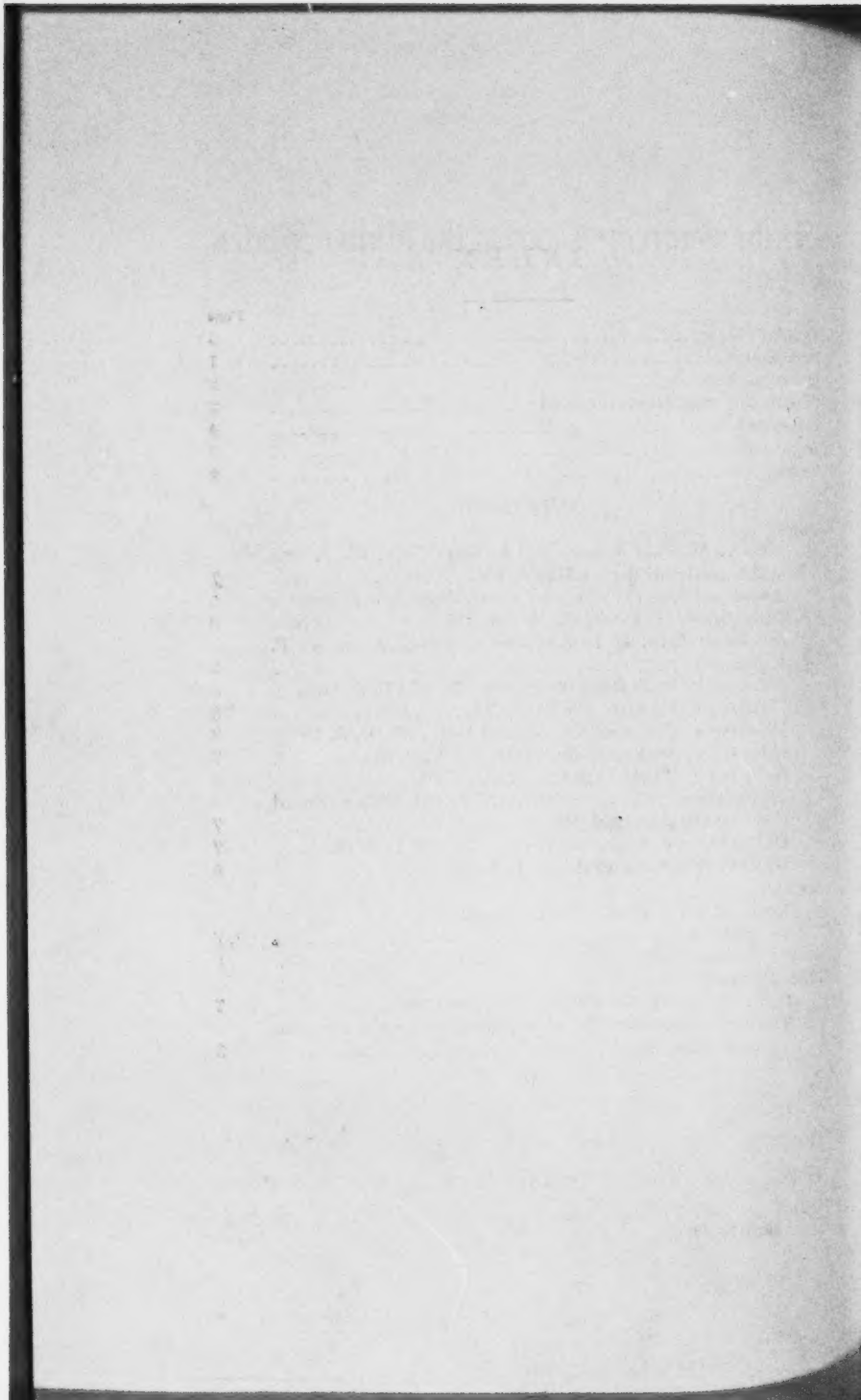

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,
PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals is unreported. (R. 18.) The opinion of the Circuit Court of Appeals (R. 36) is reported in 130 F. (2d) 145.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 1, 1942. (R. 44.) The petition for a writ of certiorari was filed October 14, 1942. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended.

QUESTIONS PRESENTED

1. Whether a corporation is taxable upon the profit realized in 1935 (a) through the exchange of its own repurchased treasury stock for the stock of another corporation, and (b) through the sale of similarly repurchased treasury stock to its employees. This question in turn depends upon the applicability of Treasury regulations under the Revenue Act of 1934, which differed from the regulations under the earlier revenue acts.

2. Whether the acquisition by a corporation, in exchange for its own stock, of a portion of the voting stock of another corporation constitutes a "reorganization" within the meaning of Section 112 (g) of the Revenue Act of 1934, if other portions of the voting stock had previously been purchased by the acquiring corporation for cash.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried

on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(g) *Definition of reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–16. *Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposi-

tion by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Act.

STATEMENT

The following material facts are contained in the findings of the Board of Tax Appeals:

1. The petitioner is a New York corporation engaged principally in the manufacture and sale of

oxygen and other derivations of air, acetylene, and carbide. (R. 16.)

During 1935 the petitioner exchanged 5,258 shares of its treasury stock, which it had previously reacquired at a cost of $182,536.73, for 22,347 shares of the stock of Pure Carbonic Company of America, the fair market value of the latter being $888,602. (R. 16.) This exchange of stock was made between petitioner and U. S. Industrial Alcohol Company. (R. 17.) During 1935 Pure Carbonic Company was operated as a subsidiary of petitioner. (R. 17.) Previous to the exchange in question petitioner had purchased 14,771 shares of Carbonic Company for cash. (R. 17.) This purchase plus the stock already owned by petitioner and the subsequent exchange here in question gave petitioner ownership of the entire outstanding stock of Pure Carbonic Company. (R. 17.)

2. Also during the year 1935, petitioner sold to various officers of its company 3,200 shares of its treasury stock for $184,480 which it had previously reacquired for $120,973.81. (R. 17.) This stock was sold pursuant to options granted the officers some two years before. (R. 17.)

In computing its net taxable income, the petitioner did not include the difference between the cost of the 5,258 shares of its own stock, which it

held as treasury stock, and the value of the 22,347 shares of Pure Carbonic stock received in exchange therefor. (R. 16–17.) Petitioner did include as taxable income the difference between the cost of its 3,200 shares and the amount received therefor upon the sale to officers of the company but later sought a refund of the tax so paid on the ground that the inclusion of this item was erroneous. (R. 17.)

The Board of Tax Appeals held that the petitioner realized no taxable gain in either of its transactions and that it had overpaid its tax for the year involved. (R. 20.) The Circuit Court of Appeals reversed and remanded on both questions.

ARGUMENT

1. This case arises under the Revenue Act of 1934; and the regulations promulgated under that Act (Regulations 86, Article 22 (a)–16, *supra,* pp. 2–4) have always provided that a corporation which realizes a profit from dealing in shares of its own stock is subject to tax with respect thereto. Although it is true that the regulations under the earlier acts did not so provide, there is not here presented any such question of retroactive application of amended regulations as was involved in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110. The propriety of a prospective amendment of Treasury regulations has been firmly established. *Helvering* v. *Wilshire Oil Co.,* 308

U. S. 90; *Helvering* v. *Reynolds*, 313 U. S. 428; *American Chicle Co.* v. *United States*, No. 913, 1941 Term; cf. *White* v. *Winchester Club*, 315 U. S. 32, 39–40. And the lower courts have uniformerly upheld the applicability of the regulations here involved to transactions consummated after the enactment of the 1934 Act. *Trinity Corp* v. *Commissioner*, 127 F. (2d) 604 (C. C. A. 5), certiorari denied October 12, 1942, No. 220, 1942 Term; *Allen* v. *National Manufacture & Stores Corp.*, 125 F. (2d) 239 (C. C. A. 5), certiorari denied May 4, 1942, No. 1091, 1941 Term; *Investment Corp. of Philadelphia* v. *United States*, 43 F. Supp. 64 (E. D. Pa.). Moreover, the court below correctly ruled, following the regulations, that the profit realized through the transactions in its own shares was taxable; the corporation was here dealing "in its own shares as it might in the shares of another corporation." That the regulations were intended to apply in such circumstances was explicitly recognized in G. C. M. 16,651, XV–2 Cum. Bull 130.[1]

[1] Both the petition and brief of *amici curiae* undertake to argue generally that the profit here involved cannot be taxed as "income". However, it has been frequently recognized that Section 22 (a) defining gross income is co-extensive with constitutional power (*Helvering* v. *Stockholms &c. Bank*, 293 U. S. 84, 89; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93), and the charge that such profit cannot be taxed as income is therefore wholly without substance. In essence, this case raises only the question whether the regulations are valid.

2. Although no plan of reorganization is even remotely involved, petitioner also contends that the exchange of its voting stock for the voting stock of its subsidiary constituted a "reorganization" within Section 112 (g) of the Revenue Act of 1934, and that therefore the profit realized was relieved of tax under Section 112 (b) (3). *Commissioner* v. *Dana,* 103 F. (2d) 359 (C. C. A. 3), is cited in support of this proposition and in conflict with the decision below. The *Dana* case, which is questionable even as an interpretation of the Act there involved, dealt with a "reorganization" as defined by Section 112 (i) of the Revenue Act of 1928. The instant transaction, however, is governed by the 1934 Act which provides that a reorganization occurs if in the exchange the petitioner gives *solely* its voting stock. The difference which the addition of the word "solely" in the later Act creates in the operation of the two Acts was treated in *Helvering* v. *Southwest Consolidated Corp.,* 315 U. S. 194, which turned on precisely that point. That decision not only renders the *Dana* case no longer applicable but controls this case.

Petitioner attempts to avoid the ruling of the *Southwest Consolidated* case by asserting that it acquired enough stock in the subsidiary through the exchange of securities alone to constitute the transaction a reorganization, without any neces-

sity for considering the stock it purchased for cash. But this argument misses the point. The requirement that the petitioner acquire the stock of the subsidiary *solely* in exchange for its own stock applies to all acquisitions of the subsidiary's securities, not just to acquisitions of 80 percent of them, as the language of the statute makes clear.[2] The statute imposes two separate conditions, first, that the corporation must acquire at least 80 percent of the voting securities, and second, that the exchange be solely for its own stock. There is no basis in the statute for circumventing the second condition, merely because 80 percent of the securities had been acquired for stock.

Moreover, the 22,347 shares of Pure Carbonic Company which petitioner acquired in exchange for its own stock constituted far less than 80 per cent of the Carbonic Company's stock. It was only by uniting this exchange with other exchanges in prior years that the requisite percentage was attained; and the record does not disclose that the various exchanges were part of a single plan of reorganization. Accordingly, neither the transac-

[2] The statute provides that the term "reorganization" means "the acquisition by one corporation in exchange solely for all or a part of its voting stock: of *at least* 80 per centum of the voting stock and *at least* 80 per centum of the total number of shares of all other classes of stock of another corporation." [Italics supplied.]

tion here in question (involving less than 80 per cent of the Carbonic Company's stock), nor all the exchanges taken together, fall within Section 112 (g).

CONCLUSION

The decision of the circuit court of appeals is correct, and there is no conflict. We respectfully submit that the petition for certiorari should be denied.

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NOVEMBER 1942.

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Supreme Court of the United States

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR PETITIONER

The Government's brief (pp. 8-10), in attempting to show that the acquisition by the petitioner of the remaining minority shares of its subsidiary company in exchange for its own stock did not come within the reorganization provisions of the statute, advances the following two arguments:

1. In the final transaction in question, less than the required statutory percentage of the stock of the subsidiary was acquired; and

2. Since the petitioner had previously acquired some shares of its subsidiary's stock by cash purchases, such cash purchases prevented the application of the reorganization provisions of the 1934 Act, under the *Southwest Consolidated* decision (315 U. S. 194).

In the Government's brief, those two arguments are hopelessly intermingled and confused. Considered separately, neither one will stand analysis.

1. In the *Dana* case, as in the present case, the parent corporation acquired the remaining minority shares of a subsidiary company from the sole remaining minority stockholder in a single transaction. In both cases, the parent corporation already owned the majority of the shares of the subsidiary and acquired all the remaining shares in exchange for its own voting stock in a final transaction without any written plan of reorganization. In the *Dana* case, such final transaction was nevertheless held to be a reorganization, within the terms of the statute. The argument in the present case that the decision of the Court below can be justified on the ground that the final transaction involved less than 80% of the stock of the subsidiary brings that decision squarely in conflict with the decision of the Third Circuit in the *Dana* case.

2. The argument that petitioner's prior cash purchases of less than 18% of the subsidiary's stock prevented the application of the reorganization provisions of the 1934 Act, under the decision of this Court in the *Southwest Consolidated* case, is obviously unsound. So long as at least 80% of the stock is acquired solely in exchange for voting stock of the acquiring corporation the statute applies; and it makes no difference whether the acquiring corporation, in other transactions, acquires the balance of the stock or not. If the Government's argument were sound, then the cash purchase by a corporation of a single share of the stock of another corporation would prevent the application of the reorganization provisions of the 1934 Act, even though the purchasing corporation subsequently acquired all the remaining shares of the other corporation in a single transaction solely in exchange for its own voting stock.

As pointed out in petitioner's main brief (pp. 12-13), that provision in the 1934 Act does not affect the present

case, and this Court's decision in the *Southwest Consolidated* case is not susceptible of any such interpretation. The fact that such interpretation was apparently adopted by the Court below and has been seriously advanced in the Government's brief in this Court is an additional reason why certiorari should be allowed, so that this Court can correct any such erroneous interpretation of its decision.

The petition for certiorari should be granted.

November, 1942.

Respectfully submitted,

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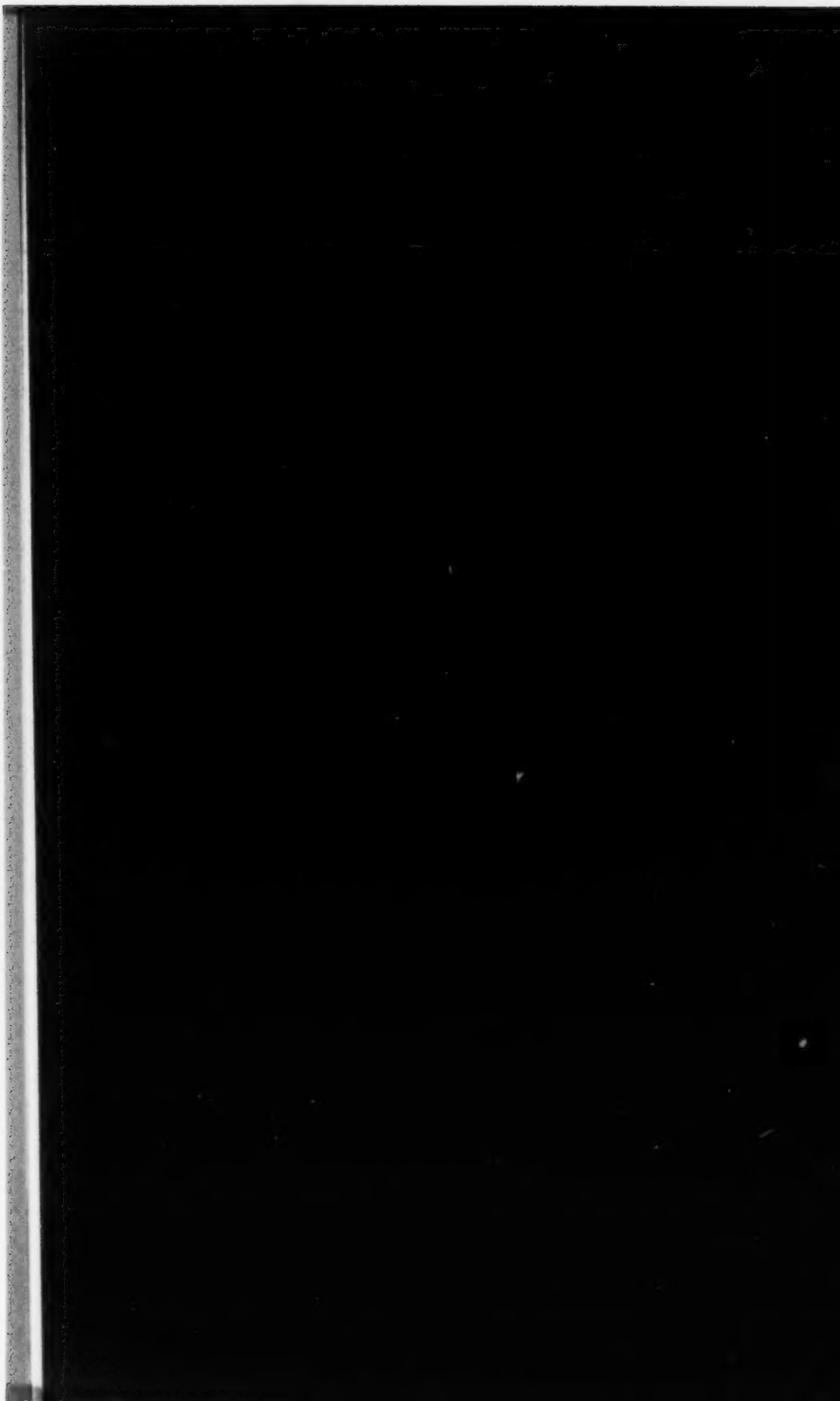

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 456

AIR REDUCTION COMPANY, INCORPORATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF AMICI CURIAE.

This brief is submitted on behalf of Brown Shoe Company, Inc., pursuant to the accompanying written consent of the respective parties.

Statement.

The Commissioner of Internal Revenue has determined deficiencies in income tax for the year 1935 against the petitioner. The basis for his determination is that petitioner, prior to the year 1935, re-acquired certain shares of its capital stock, which shares were not cancelled, but remained in its treasury. During the year 1935, the peti-

tioner reissued certain of its treasury stock in exchange for a small remaining balance of publicly held stock of a subsidiary company and, also, during the same year, petitioner sold certain shares of its treasury stock to certain of its officers in accordance with an option given them in 1933. The Commissioner determined that the difference between the re-acquisition price of the stock sold or exchanged in 1935 and the price at which it was so sold or exchanged represented taxable gain to petitioner.

The United States Board of Tax Appeals (now The Tax Court of the United States) in an unreported memorandum opinion dated May 19, 1941, determined that petitioner had realized no taxable gain from the purchase and resale of its capital stock. The United States Circuit Court of Appeals for the Second Circuit on July 16, 1942 (130 F. (2d) 145), reversed the decision of the Board of Tax Appeals and petitioner seeks a review of that decision.

The questions in this litigation which particularly concern the *amici curiae* are:

> 1. Does Article 22(a)-16, Regulations 86, involved herein, correctly interpret Section 22(a) of the Revenue Act of 1934?
>
> 2. If it does, was the petitioner dealing in its own shares as it would in the shares of another corporation?

Upon the answer to these two questions depends the determination of whether petitioner realized taxable gain in selling to its officers under options previously given to them, shares of its treasury stock.

Reasons for Allowance of the Writ.

1. Numerous cases involving the questions presented here are now pending in several Federal Courts.

Brown Shoe Company, Inc., on whose behalf this brief is filed, is petitioner in the case of *Brown Shoe Company, Inc.* v. *Commissioner,* now pending before the United States Circuit Court of Appeals for the Eighth Circuit. Briefs have already been filed and oral argument is to be heard before the court on November 10, 1942. That case involves a determination of whether under Article 22(a)-16, Regulations 94, the provisions of which are substantially similar to the provisions of Article 22(a)-16, Regulations 86, involved herein, and Section 22(a) of the Revenue Act of 1936, which was a re-enactment of the same provisions of the 1934 Act, the taxpayer realized taxable gain in the sale of treasury stock to its president and certain "key employees".

There are also pending before the United States Circuit Court of Appeals for the Eighth Circuit, the cross-petitions of *Helvering* v. *Edison Bros. Stores, Inc.* and *Edison Bros. Stores, Inc.*, v. *Helvering,* involving the same sections of the 1934 and 1936 Revenue Acts and the same articles of the Regulations 86 and 94 promulgated thereunder. Oral argument on these cross-petitions has been set for November 10, 1942, just preceding oral argument in the case of *Brown Shoe Co., Inc.* v. *Commissioner.*

An appeal has also been taken from a decision of the United States District Court, Western Division of the Western District of Missouri, in *Stern Bros. & Co., Inc.* v. *United States,* 45 Fed. Supp. 583 (July 6, 1942), to the United States Court of Appeals for the Eighth Circuit. That case, too, arises under Section 22(a) of the Revenue Act of 1936 and involves the resale to officers and employees of treasury stock previously acquired.

There are also cases now pending before the United States Court of Claims involving this same question.

2. The Supreme Court of the United States specifically left undetermined the question involved herein when it

decided in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 308 U. S. 110, 116, that a 1934 amendment to Article 66 of Treasury Regulation 74, promulgated under the Act of 1928, which was intended to apply retroactively the same provisions as are contained in Article 22(a)-16 of Regulations 86, here involved, did not correctly interpret Section 22(a) of the 1928 Act.

The numerous Judges called upon to decide the above pending cases and several recently decided cases have by no means been in accord either in their results reached or their analyses of the problems left undecided by the *Reynolds Tobacco Co.* case, *supra.* Thus the decision in the instant case by the Second Circuit Court of Appeals not only reversed the Board of Tax Appeals (now the Tax Court of the United States) in this case, but was decided over the vigorous dissent of Judge Learned Hand, and reversed the prior rule of this same Circuit Court which had been announced in the case of *E. R. Squibb & Sons* v. *Helvering,* 98 F. (2d) 69, Mod. 102 F. (2d) 681. The confusion existing in the Second Circuit is duplicated in other courts and in the Board of Tax Appeals. Thus in *Brown Shoe Company, Inc.* v. *Commissioner,* 45 B. T. A. 212, the Board reversed its earlier decision in *National Home Owners Service Corp.* v. *Commissioner,* 39 B. T. A. 753. The Eighth Circuit Court of Appeals, which now has the duty of reviewing that decision against the taxpayer, also has pending a decision in favor of the taxpayer on this same question (*Stern Bros. & Co., Inc.* v. *U. S., supra*). It is respectfully submitted that the Supreme Court should certainly take jurisdiction to terminate the hopeless confusion in which the lower courts now find themselves.

3. The facts to which the Commissioner herein seeks to apply the regulations typify situations which are recurrent in modern corporate enterprise. This case involves transfer of treasury stock to certain officers of petitioner. It is

well known that the custom of encouraging employees and officers to purchase stock of the companies for which they are working is a device for maintaining the loyalty and cooperation of employees which has become more and more widespread in recent years. The instant case also involves transfer of treasury stock to a controlled corporation in return for its stock. The increasing amount of litigation and remedial legislation centering around the scope of tax-free inter-corporate reorganizations and exchanges of stock is too well known to require citation of specific instances.

Both of these types of factual situations are becoming more and more frequent, and this Court should take jurisdiction to settle the conflicts in the lower courts now harassing both taxpayers and government in their search for a tax policy upon which they can safely rely.

4. The decision of the Circuit Court of Appeals in the instant case apparently laid down a rule which will seriously affect and confuse collateral rules of tax law. The majority of the court below based their interpretation of the regulations as applied to the facts herein upon the principle that taxation will follow use of treasury stock "as an ordinary asset". The question of the extent to which shares of a corporation's own stock may be deemed to be an ordinary asset is a typical one. In *Eisner* v. *Macomber,* 252 U. S. 189, this Court held that the distribution of stock of a corporation could not be considered a distribution of an asset, under certain circumstances. (Compare: *Koshland* v. *Helvering,* 298 U. S. 441, wherein this Court held the treasury regulations to have misconstrued the law as enunciated in *Eisner* v. *Macomber.*) Recently the question of whether or not a dividend declared and payable in treasury stock may be considered the distribution of an asset within the scope of the income tax law has arisen, and the Board of Tax Appeals has twice ruled that such a dividend does not constitute taxable income. *Bruckheimer* v. *Commis-*

sioner, 46 B. T. A. 234; *Travis* v. *Commissioner,* (unreported officially, Prentice-Hall B. T. A. Memorandum Service, 1942, Para. 42,386). The decision of the majority of the Circuit Court of Appeals in the instant case is opposed in principle to this rule. This additional conflict of principles affords a further reason for this Court to take jurisdiction in the case at bar.

ARGUMENT.

1. Article 22(a)-16, Regulations 86 does not correctly interpret Section 22(a) of the Revenue Act of 1934.

Prior to May 2, 1934, Treasury regulations promulgated under the various Revenue Acts, commencing at least with those issued under the 1918 Act, uniformly provided that "a corporation realizes no gain or loss from the purchase or sale of its own stock". During that same period, beginning at least with the 1918 Act and extending through the Revenue Acts of 1921, 1924, 1926, 1928 and 1932, the statutory provisions of which the regulations were interpretative, were reenacted without any material change. The Supreme Court of the United States in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 308 U. S. 110, held that the repeated reenactment of the statutory provisions, while the regulations interpretative thereof remained unchanged, gave to such regulations the force of law. Section 22(a) had, therefore, gained a settled meaning which was applied by the Supreme Court in that case.

The change made in the regulations took place on May 2, 1934, before which time both the House of Representatives and the Senate had acted upon the 1934 Revenue Act, in which Section 22(a) was reenacted without change. The Conference Report was adopted by both the Senate and the House but one day after the change in regulations, and it cannot be said, even if the Commissioner of Internal

Revenue had the power, that he by that change in regulations brought about a change in the meaning of "gross income", as it had been used in all of the Revenue Acts up to and including the 1932 Act.

Furthermore, the uniform provision of the regulations, that a corporation does not realize gain or loss from the purchase or sale of its own stock, is in accordance with the true nature of the transaction, and the change in regulations seeks to tax as income that which by its nature does not constitute income.

A corporation, when it reacquires shares in itself, obtains nothing that can be called a true asset. A corporation cannot own an interest in itself. The fact that it may carry that stock as treasury stock does not make of the stock a true asset. When the corporation sells shares in itself, it makes no difference whether it sells treasury stock or a new issue. It is simply acquiring new assets *at that time* and giving the vendor an interest in itself along with its other stockholders. It is a capital transaction whether or not it sells treasury stock or a new issue, and no income has been realized in either event. The change in regulations, therefore, attempts to tax as income that which is not income.

2. Petitioner's sale of treasury stock to its officers did not constitute dealing in its own shares as it might in the shares of another corporation.

It is obvious that what petitioner was doing was to give its officers an interest in their corporation. If a "similar" transaction were carried out in the shares of another corporation, its effect would necessarily be entirely different. The pride of proprietorship, which an officer has in his own corporation when he owns shares of stock in that corporation, could never be present when he is sold the shares of stock in some strange corporation. What they acquired

was part of or interest in the proprietorship of the petitioner, and that could not have been acquired through the sale of shares of another corporation.

Conclusion.

It is submitted that, for the reasons pointed out, the decision of the court below presents Federal questions of general importance, which have not been decided by this Court. Those questions were left undetermined in the prior decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co., supra,* and those questions are involved in numerous cases now pending before Federal Courts, including the United States Court of Appeals for the Eighth Circuit and the United States Court of Claims, and those questions should be decided by this Court.

The Petition for a Writ of Certiorari should be granted.

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